ANNUAL REPORT

Department of Finance

for the Year Ended 31 March, 2002

GOVERNMENT OF
NEWFOUNDLAND AND LABRADOR

103-03885/

MESSAGE FROM THE MINISTER
Honourable Joan Marie Aylward

Timely, professional, quality service defines the Department's commitment to the attainment of its primary goal, which is to deliver the necessary support for Government programs and policies within acceptable fiscal limits. The Department can be justifiably proud of the significant gains it has made during the fiscal year ended 31 March, 2002.

As part of efforts to address the large unfunded liabilities of Government's pension plans, a system of annual special payments has been instituted and the funds for these payments have been raised with substantially no negative impact on Government's access to capital markets or on its borrowing costs.

The Department has implemented the second year of personal income tax rate reductions announced in 1999. These reductions have been undertaken without causing a material deterioration in revenues, and this has resulted in our taxation level being more compatible with our Atlantic counterparts.

The Department also is developing a system of statistical measurement and audit programs to support Government's many strategic initiatives, such as the Strategic Social Plan and the Renewal Strategy for Jobs and Growth. The system of community accounts and statistical auditing being developed by the Department is a "made in Newfoundland and Labrador" solution which is receiving national interest. The system will measure the outcome of specific expenditure and other support programs and, as well as, help identify new program requirements specific to each region throughout the Province.

Government continues to face fiscal challenges and the Department of Finance, not unlike other departments, has had to learn to do more with less. It is with a great deal of gratitude that I take this opportunity to thank the Department's employees for their initiatives, dedication and support. While the job is not complete, it is my belief that the Department will build on its success. I look forward to another successful year in 2002-03.

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DEPARTMENTAL OVERVIEW

DEPARTMENTAL PROFILE

The Department of Finance, created by separate Order-in-Council under the Executive Council Act, is one of two agencies responsible for the provision of financial and economic services necessary to support all Government activities and programs. The Department is responsible for those activities relating to taxation; federal-provincial fiscal arrangements; analysis of the impact of specific projects; analysis of the provincial economy including statistical collection; the borrowing, cash management and debt servicing programs of Government and its municipal lending agency, Newfoundland and Labrador Municipal Financing Corporation; and the administration of its internal pension programs. The other agency, Treasury Board, is responsible for the financial operations of Government such as budgeting; human resources management; the Public Accounts and financial systems.

The activities of the Department affect taxpayers of the province, policy groups in Executive Council and Government departments, the financial community, and employees of Government and its Crown Corporations, agencies and boards.

The Department of Finance has 173 permanent employment positions in three separate branches: Debt Management and Pensions Administration; Taxation and Fiscal Policy; and Economics and Statistics. Each is responsible to an Assistant Deputy Minister, reporting to the Deputy Minister of Finance who, in turn, is responsible to the Minister.

VISION

It is the vision of the Department of Finance to ensure sufficient financial and economic resources are available to promote prosperity and well-being among the people of the Province of Newfoundland and Labrador.

MISSION STATEMENT

The Mission of the Department of Finance is to provide the necessary financial and economic resources to support effectively Government programs and policy development within a responsible fiscal framework, while ensuring the tax system is fair to all taxpayers.

MAJOR LINES OF BUSINESS

The following summarizes the major lines of business for each of the three Branches.

DEBT MANAGEMENT AND PENSIONS ADMINISTRATION BRANCH

Liability Management and Loan Administration:

Administration of the Province's borrowing and debt management programs, including cash management and the investment of trusteed assets, and the operation of Government's senior guaranteed financial assistance programs.

Pensions Administration:

Administration of Government's internal pension program, including the delivery and communication of benefit services and the investment of related trusteed assets.

TAXATION AND FISCAL POLICY BRANCH

Fiscal Policy:
Negotiation and administration of all programs under federal-provincial fiscal arrangements; forecasting, and analysis of provincial revenues; coordination of the annual Budget speech including the pre-budget consultation process; and analytical support for the development of Government's fiscal policy.

Project Analysis:
Analysis of the financial and economic impact of specific projects to assist Government in policy development.

Tax Policy:
Assessment of existing provincial taxation policies, options for taxation reform and new revenue proposals, and the negotiation and monitoring of federal-provincial tax agreements.

Tax Administration:
Administration and collection of various provincial taxes.

ECONOMICS AND STATISTICS BRANCH

Economic Research:
Analysis and forecasting of the macroeconomic environment; provision of specific economic analysis and studies related to policy and project impact assessments.

Statistical Services:
Administration of statistical and analytical services which, in addition to linking Government to Statistics Canada, concentrates on the development of specific and unique information necessary for Government's policy development.

SHARED COMMITMENTS

In addition to responsibility for Government's revenue and borrowing program, the Department of Finance provides all information relating to economic research and statistical analysis necessary to support the activities of all Government departments, boards and agencies. As well, the Newfoundland and Labrador Statistics Agency provides statistical reports and commentary as requested by other provincial and many national institutions. The Department also is responsible for those pension plans affecting all public servants, teachers, and employees of substantially all of its boards, agencies and commissions.

Major initiatives undertaken during the year in partnership with other agencies included:

Debt Management and Pensions Administration Branch

While Treasury Board has responsibility for collective bargaining for the public service and employees of many of its Crown agencies and boards, a recent shift in emphasis has included pensions as a negotiated benefit. As part of that process, the Department is called upon to provide financial and benefit advice to support Government's bargaining position during these negotiations. During the 2001-02 fiscal year Government and public sector unions reached agreement on changes to the Public Service Pension Plan. Negotiations having a pensions component were ongoing during 2001-02 with the Newfoundland and Labrador Teachers Association (NLTA), the correctional officers and the Royal Newfoundland Constabulary Association (RNCA). Treasury Board, as Government's chief negotiator, has relied to a large extent on the advice and guidance of the Department on the pensions component of these negotiations.

The Branch also is responsible for the administration of the Newfoundland and Labrador Municipal Financing Corporation which provides long term financing for the capital works programs of many municipalities. In that respect, it works closely with the Department of Municipal and Provincial Affairs.

Responsibility for the administration of the Newfoundland Government Fund Limited, this Province's immigrant investor fund, requires the Department of Finance to liaise closely with both the Department of Health and Community Services, and the Department of Education, as each investment is being considered.

Taxation and Fiscal Policy Branch

While interdepartmental commitments involving the Taxation and Fiscal Policy Branch vary from project to project, there is regular interaction with the Executive Council, and its Secretariats. For example, there is continuing consultation with Treasury Board on matters pertaining to the preparation of the Budget and the coordination of the pre-Budget consultation process. Similarly, there is ongoing liaison with the Intergovernmental Affairs Secretariat on various federal-provincial financial issues, particularly in preparation for the Annual Premiers' Conference.

The development of taxation policy can also involve various departments, depending on the nature of the tax and its impact on Government programs. For example, policy development related to the Newfoundland and Labrador Child Benefit was a joint project between the Taxation and Fiscal Policy Branch of the Department of Finance, and the Department of Human Resources and Employment.

Also, financial analysis to support the Voisey's Bay project negotiations was done by the Project Analysis Division of the Branch for the Department of Mines and Energy. Also, the Fiscal Policy Division provided background information about the equalization program for the Strategic Partnership Initiative, a partnership among business, labour, and Government resulting from the Renewal Strategy for Jobs for Growth.

Economics and Statistics Branch

In relation to its Demographic Study, the Economics and Statistics Branch worked with those provincial departments providing social programs, municipal services and economic development. The primary departments include; the Departments of Human Resources and Employment, Justice, Education, Health and Community Services, Municipal and Provincial Affairs, and Industry, Trade and Rural Development. The Branch also worked with ACOA and provincial educational institutions such as Memorial University. As well, the SSP regional steering committees and community development groups throughout the various regions of the Province are contributing to the process.

The Strategic Partnership Initiative requires the Economics and Statistics Branch to work closely with the Department of Industry, Trade and Rural Development to provide a better understanding of the economy, its structure, economic forecasting and other factors that affect general economic performance.

The Branch worked with Executive Council in relation to the Strategic Social Plan to develop the database for the Community Accounts, and with those social policy departments in preparing the Landscape Document for the related social audit.

KEY ACHIEVEMENTS AND PRIORITIES

The Department has identified five key strategic issues which need to be addressed over the next four years:

1 To maintain a responsible fiscal position in the face of increasing demands for tax decreases and additional resources to finance Government programs and services.

At 31 March, 2002 the direct debt of the Province, excluding the $3.4 billion unfunded pension liability, amounted to $6.7 billion. Government has agreed to make annual payments into the Pension Fund to address the unfunded liabilities and these amounts will have to be borrowed in the capital markets. Total debt servicing cost amounted to $544 million for the year ended 31 March, 2002 as compared to $541 million in the year ended 31 March, 2001. Over the same period, the annual budgetary deficit increased from $26 million to $47 million.

The low interest rate environment has had a positive impact on stabilizing debt servicing costs. This has provided opportunities for the Department to restructure its existing debt profile to accommodate the debt servicing cost associated with financing the unfunded pension liabilities, without placing undue demands on Government's revenues or materially reducing expenditures in core programs.

The funding of its pensions program, Government's fiscal management record, and the anticipated economic impact of major projects in offshore oil and gas, and the mining development in Labrador has been well received by national financial institutions and credit rating agencies.

2 Increased requests for economic information and statistical support related to Government's strategic initiatives, such as the Strategic Social Plan and Jobs and Growth Strategy is creating additional demands on Departmental services.

In 2000-01 Government announced its Strategic Social Plan which outlines a framework for the development of provincial social policy. There are two critical elements of the Strategic Social Plan which affect the business of the Department. Firstly, Government has placed greater emphasis on obtaining more complete statistical evidence to support the decision making process. The Newfoundland and Labrador Statistics Agency has been directed to play a major role in the development of relevant statistical support and information for Government and its partners. Secondly, the Department has been given responsibility for the development of a Social Audit designed to review and monitor the Strategic Social Plan as it is being implemented.

Also, a major Demographic Study was initiated in fiscal year 2000-01 which is scheduled to be released in 2002-03. Included in this Study are the long-term population projections related to several Government strategic initiatives. Already, these are available on the Department's website. Regional consultations will facilitate the development of detailed regional population projections. Based not only on population dynamics but also on major project development, the labour market outlook, and other key economic drivers, the population projections provide essential information on current and future labour supply in the various regions of the Province. These projections, including the distribution of the population by age, will be updated periodically, as new information becomes available.

Several initiatives have been undertaken in support of the Strategic Social Plan. Statistical information and analytical tools are being developed to help resolve problems based on detailed knowledge of the social, economic, and demographic situation in each of the various regions in the Province. This added knowledge will support the Social Audit and enable Government to measure progress. Specifically, there are three major initiatives which have to be addressed: (1) creation of Community Accounts which will provide statistical information for 400 communities to be used to support the development of various progress indicators; (2) development of social, economic, and demographic indicators against which social and economic progress can be measured; and (3) ongoing development of a Social Audit model, method and approach.

It is anticipated that the new statistical information and analytical tools will be well received and widely utilized. Already the concept of a system of Community Accounts has received national attention. With the release of the "landscape" Report, the Province will be one of the first in Canada to provide such comprehensive social and economic indicators in a user friendly, easily accessible format.

Also, a full range of statistical information including economic, demographic, and labour market information is available on the Economics and Statistics Branch's website. This website is an integral part of the Branch's operations and is continually being enhanced and developed. Individual sites are monitored constantly for response and feedback and their reactions are the basis for future changes. Some sites have very high rates of usage. For example, Regional Population Projections and large parts of the Community Accounts, two major data sets drawing a lot of interest, were added to the site in 2001-02.

3 Unions and pensioners are calling for pension benefit improvements, in the face of large pension unfunded liabilities.

Historically, Government pension plans have been underfunded as total contributions have not been sufficient to cover the cost of benefits. As well, benefit improvements have been made without regard to cost, or how they are to be financed. Many plan members still feel that Pensions are a part of Government social policy and, therefore, any associated cost should be paid by the taxpayers. In fact, pensions are a part of total employee compensation and, as a matter of policy, Government is now negotiating all changes to its pension plans with its unions.

The major issue for all plan members is indexing of retirement benefits. This has become more important as all other provincial government plans contain some form of indexing.

Public pressure, often through demonstrations, is being placed on Government by retirement organizations to address the indexing issue. In response, a Committee of Officials of the Department was established to discuss indexing with the Public Service Pensioners Association which has adopted the position that indexing should be included as a matter of right.

Also, at the beginning of the 2001-02 fiscal year the major public sector bargaining groups, including NAPE, CUPE and the NLTA, publicly stated that indexing will be a major focus during the next round of negotiations. In June of 2001, Government was successful in negotiating a modest indexing program with those public sector unions whose members participate in the Public Service Pension Plan. The cost of that provision will be shared equally between employers and their employees through contribution increases.

As part of that agreement, Government also committed to increase the annual payments to that Plan from $40 million to $60 million. These payments are anticipated to fully finance the associated unfunded liability over 40 years.

Finally, Government and the unions agreed to implement a joint trusteeship arrangement which would transfer the responsibility for the Plan from Government to an independent Board of Trustees. A committee is to be established to resolve all issues relating to that transition and it is anticipated that its recommendations would be completed in 2003-04.

Due to changes in matrimonial property laws, the Income Tax Act and the Human Rights Code, pensions have become more complex. As part of its program to make pensions more easily understood by plan members, their beneficiaries, and participating employers, the Department is in the process of developing a pensions web page which is anticipated to be operational in the 2002-03 fiscal year.

The combined effort of additional special payments and a greater willingness of employees and their unions to accept their fair share of the costs has resulted in increased financial stability of these pension plans and this is expected to continue.

4 To modify the province's tax regime to be more competitive

Government is aware of the importance of having a competitive personal and business tax regime. To this end, there have been significant reductions in personal income tax and the health and post-secondary education tax (payroll tax).

In 1999, Government carried out a review of the provincial tax regime, and sought input from the public. Taxpayers clearly indicated that their priority for tax reductions were personal income tax and the payroll tax. They also indicated that they did not want tax reductions if it meant a reduction in core programs and services.

Later in 1999, Government announced a three year personal income tax reduction program. The reductions for 2000 and 2001 were implemented providing annual savings to taxpayers of approximately $65 million. In late 2001, because of concerns about Government's fiscal position, the third year of the personal income tax reduction was deferred. Government has not abandoned its policy to have a more competitive tax regime. However, in light of the fiscal position in the 2001-02 fiscal year, a decision was made to delay further income tax reduction until fiscal circumstances improve. This will ensure that programs and services are maintained at levels acceptable to all citizens of this Province.

Since 1998, Government has significantly reduced the payroll tax burden and the number of employers on the payroll tax roll. The payroll tax exemption threshold has been increased from $100,000 in the 1997-98 fiscal year to the current level of $500,000 in the 2001-02 fiscal year. Consequently, businesses no longer pay payroll taxes on payrolls up to the $500,000 threshold amount.

As a result of the 2001 Budget, more than 90 percent of the businesses operating in this Province no longer pay the payroll tax and more than 2,000 employers have been removed from the payroll tax roll, with tax savings of almost $9 million annually.

5 A shift in support for federal transfers is threatening revenue levels

A shift in support for federal equalization transfers threatens revenue levels, as those more affluent provinces not receiving equalization have been advocating more per capita funding through the Canada Health and Social Transfer (CHST) program. CHST is received by all provinces and if more per capita funding were introduced, most likely, it would be done at the expense of equalization transfers. Any acceptance of the proposals advanced by the affluent provinces could seriously affect the revenues of all provinces which receive equalization.

In 2001-02 the Province received $1.2 billion in equalization transfers from the Federal Government. This represented 31 percent of Government's Current Account revenues and clearly demonstrates that this Province relies on equalization transfers to fund a substantial portion of Government services.

It is also important to note that revenues received under the equalization formula will be affected negatively by the increase in those provincial revenues which are generated as the mega projects in the offshore oil and gas, and mining in Labrador, move into production. For example, for every $1 of revenue received from the Hibernia project, the Province loses approximately 70 cents in equalization transfers. Therefore, while economic growth in the Province of Newfoundland and Labrador is expected to lead the country over the next few years, the negative impact on equalization revenues is seriously impeding Government's ability to benefit fully from that increased economic activity.

As identified in the 2001 Budget Speech, the Intergovernmental Affairs Secretariat and the Department of Finance have been aggressively pursuing changes to the Federal transfer system to address this issue and provide more funding for those provinces most in need. This Province's position is being advanced through a number of forums. Officials of this Province deal with their counterparts in other provinces and the Government of Canada. In addition, Ministers deal with their respective ministers in other provinces and territories, as well as, the Federal Minister. These discussions occur through individual contact and regular meetings of the full groups.

In the 2001-02 fiscal year, both the Minister of Finance and the Premier made special representation in Ottawa detailing Government's position on Federal transfers. In April, Minister Aylward gave a presentation to the House of Commons Standing Committee on Finance which was meeting to consider Bill C-18, "An Act to amend the Federal-Provincial Fiscal Arrangements Act". This was followed in October by a presentation by Premier Grimes to the Senate Committee on National Finance Reviewing the Equalization Program.

Reform of the equalization program is a central component of an effective Federal transfer system. Government maintains that an effective Federal transfer system would benefit not only the provinces receiving equalization but the entire country. The overriding Federal transfer issue advanced by this Province is one of adequacy for both the equalization program and all Federal transfers. The issue of adequacy is highlighted by repeated calls for Federal transfer reform including: the removal of the equalization ceiling; the move to a 10 province national average standard; and comprehensive revenue coverage. In order to obtain the full support of all provinces for changes relating to CHST enhancements, the affluent provinces agreed to consider beneficial modifications to the Federal Equalization Transfer program.

Government's representations also have advocated transfer reforms to incorporate the consideration of specific needs of each of the provinces; a population floor to reduce the impact of federal transfers caused by rapidly declining population; and adjustments to allow the provinces to receive greater net benefits from resource developments.

OPPORTUNITIES AND CHALLENGES AHEAD

Canada Health and Social Transfer (CHST) Revenues

The cost of health care still remains the biggest issue for this Government, as it does for all other provinces of Canada. The Commission on the Future of Health Care in Canada, the Romanow Commission, may provide an opportunity for this Province to address some of the shortcomings in the current CHST program, such as special problems dealing with the delivery of health care services to remote areas. Such special circumstances cannot be fully addressed in the normal "per capita" component of the present CHST formula and it is hoped that any new funding for health care resulting from the adoption of the Romanow Commission report will also recognize special circumstances. The Department of Finance is responsible for negotiating this Province's portion of CHST revenue transfers. It will be advocating a restructured formula to recognize this Province's special circumstances if, as expected, the Romanow Commission recommends the infusion of additional funding to support Canada's health care system.

Pensions Financing

The Department continues to address the unfunded liability of its pensions program. Already, $136 million will be borrowed to meet commitments under the Public Service Pension Plan and the Teachers' Pension Plan. Also, two other plans covering Members of the House of Assembly and uniformed services personnel have large unfunded liabilities, and these plans will require special support payments if they are to become fully funded. In this regard, Government is now making total annual special payments of $27.5 million to these two other Plans. This increases the total annual special pension commitment to $163.5 million. While these initiatives may not achieve full funding for all Government plans, it will provide them with greater financial stability until the fiscal position of the Province improves and further adjustments can be considered.

Government Strategic Initiatives

Government has already released its Strategic Social Plan and this Report has described how a system of Community Accounts and a Social Audit program is being developed to monitor the impact of programs on the various regions throughout the Province.

In the 2001-02 fiscal year, Government announced the establishment of a Royal Commission on Renewing and Strengthening our Place in Canada which is expected to report early in fiscal 2003-04. Recommendations of this Royal Commission will be supported by various statistical and economic reports which will be provided by the Department of Finance.

Also, the Strategic Partnership Initiative, a collaborative effort between business, labour and Government resulting from the Renewal Strategy for Jobs and Growth, has recently been established and this Department will be providing technical and conceptual support as it develops its future plans and priorities.

The development of the Community Accounts, the Social Audit, and regional statistical measurement models should ensure that these additional strategic initiatives will be able to more properly identify and resolve issues central to their mandates based on more complete statistical evidence.

Tax Reductions

Government has an obligation to maintain a responsible overall fiscal position even though there is a desire for reduced taxes and an increased demand for additional resources to finance core programs and services. During the period from 1 April 1995 to 31 March, 2002 the Province's net budgetary position has averaged a deficit of $15 million per year. Also, during that period the Public Sector Debt, as a percentage of Gross Domestic Product (GDP), has decreased from 67 percent to 55 percent, and total debt (including the unfunded pension liability) expressed as a percentage of GDP has decreased from 93 percent to 79 percent. In comparison, over the same period total expenditures has increased by 14 percent. This includes health operating expenditures which increased by 42 percent.

During this period Government significantly reduced personal income tax and the payroll tax. With the implementation of the HST in 1997, the provincial sales tax rate for most goods and some services was reduced from almost 13 percent to 8 percent. All of these initiatives have been designed to reduce the tax burden on taxpayers.

Government continues to take the path of sound fiscal management which requires it to balance tax reductions with the need to increase expenditures for programs and services, especially in health care. While there has been strong growth in the economy since the 1995-96 fiscal year, it has not resulted in a similar level of growth in total revenues and, as explained, Government has had to defer further tax reductions to accommodate increasing expenditures.

Through initiatives taken by the Department, the Government of Canada is being asked to recognize the special circumstances caused by the collapse of the fishery, the subsequent population out-migration and the negative impact on Government's revenues of reductions under the tax equalization formula. This will be a singular focus of the Department's federal-provincial strategy in the coming years.

OTHER RELATED REPORTS

The Economy

The Budget Speech

The Annual Report of the Newfoundland and Labrador Liquor Corporation

The Annual Report of the C.A. Pippy Park Commission

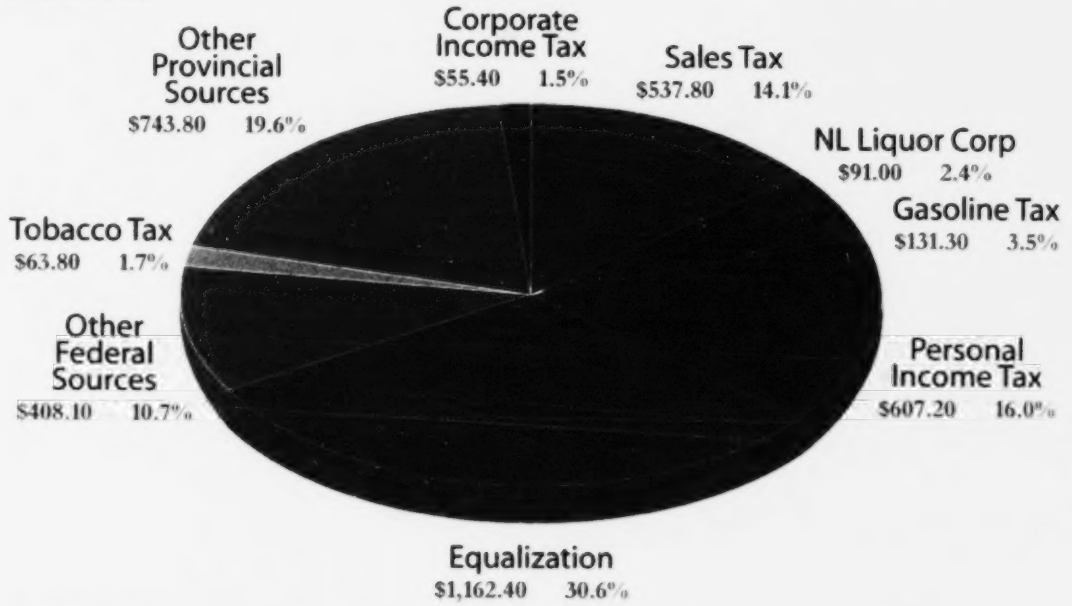
The Annual Report of the Newfoundland and Labrador Municipal Financing Corporation

DEPARTMENT OF FINANCE

SELECT
FINANCIAL INFORMATION
31 MARCH, 2002

Current Account Revenues of the Province

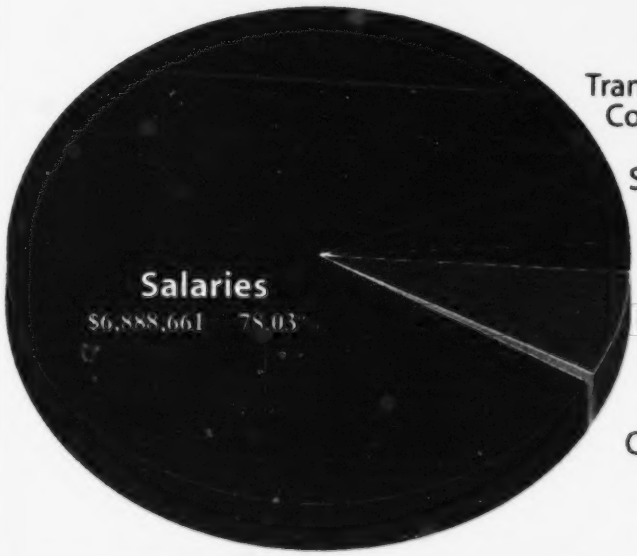
($ millions)



Total 2001-02 Current Account Revenues $3,800.80 million

Operating Expenditures of the Department of Finance *(Excluding Government Personnel Costs of $34.6 million)*

($ millions)



Transportation & Communication $632,997 7.17%

Supplies $230,693 2.61%

Purchased Service $239,964 2.72%

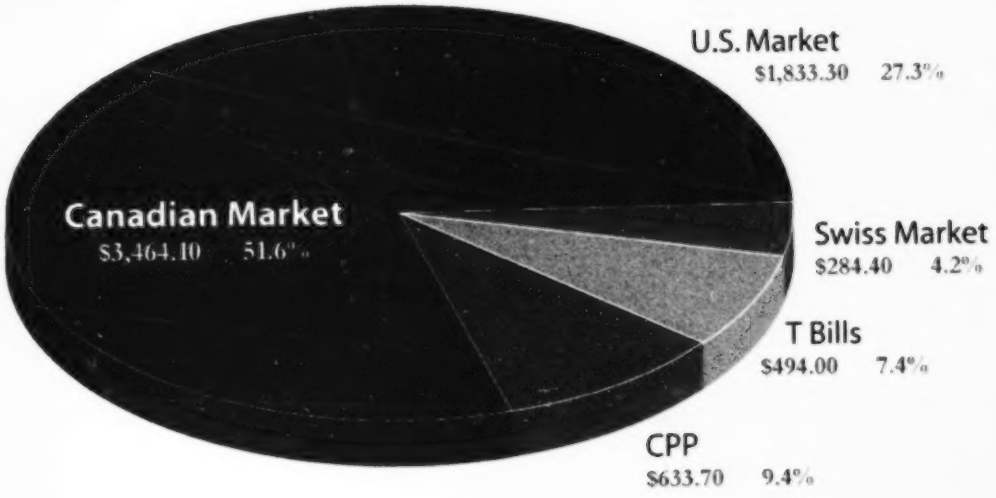
Professional Services $176,717 2.00%

Grants, Allowances & Assistance $604,000 6.84%

Other $55,510 0.63%

The Province's Direct Debt By Source

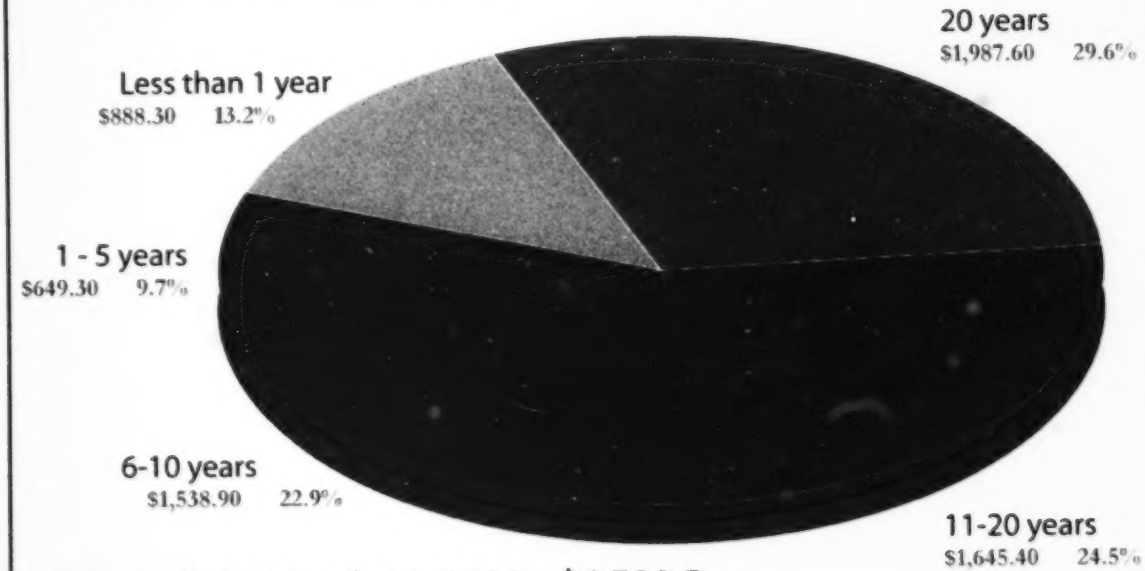
($ millions)



Direct Debt March 31, 2002: $6,709.5

The Province's Direct Debt by Term to Maturity

($ millions)



Direct Debt March 31, 2002: $6,709.5